

# **The Methodist Hospitals, Inc.**

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## **Consolidated Financial Report December 31, 2011**

# **The Methodist Hospitals, Inc.**

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Plante & Moran, PLLC  
Suite 400  
634 Front Avenue N.W.  
Grand Rapids, MI 49504  
Tel: 616.774.8221  
Fax: 616.774.0702  
plantemoran.com

## Independent Auditor's Report

To the Board of Directors  
The Methodist Hospitals, Inc.

We have audited the accompanying consolidated balance sheet of The Methodist Hospitals, Inc. (the "Hospital") as of December 31, 2011 and 2010 and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Methodist Hospitals, Inc. at December 31, 2011 and 2010 and the consolidated results of its operations, changes in net assets, and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*Plante & Moran, PLLC*

April 20, 2012

# The Methodist Hospitals, Inc.

## Consolidated Balance Sheet

	December 31, 2011	December 31, 2010
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 19,345,002	\$ 34,156,290
Short-term investments (Note 5)	4,707,401	3,185,112
Accounts receivable (Note 2)	30,813,413	18,322,824
Cost report settlements receivable (Note 3)	26,153,626	-
Current portion of assets limited as to use (Note 5)	2,489,027	640,061
Other current assets (Note 7)	11,023,071	11,321,558
Total current assets	94,531,540	67,625,845
<b>Assets Limited as to Use - Net of current portion (Note 5)</b>	127,288,581	141,458,199
<b>Property and Equipment - Net (Note 8)</b>	122,830,854	126,101,815
<b>Other Assets</b>	1,190,053	1,503,010
Total assets	<b>\$ 345,841,028</b>	<b>\$ 336,688,869</b>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Current portion of long-term debt (Note 10)	\$ 3,703,792	\$ 3,518,507
Accounts payable	8,971,752	7,375,155
Cost report settlements payable (Note 3)	7,398,859	7,785,462
Accrued liabilities and other (Note 9)	15,061,638	15,129,645
Total current liabilities	35,136,041	33,808,769
<b>Long-term Debt - Net of current portion (Note 10)</b>	83,748,010	89,658,798
<b>Other Liabilities (Note 11)</b>	43,716,666	33,383,468
Total liabilities	162,600,717	156,851,035
<b>Net Assets</b>		
Unrestricted	182,984,820	179,299,546
Temporarily restricted	230,491	513,288
Permanently restricted	25,000	25,000
Total net assets	183,240,311	179,837,834
Total liabilities and net assets	<b>\$ 345,841,028</b>	<b>\$ 336,688,869</b>

# The Methodist Hospitals, Inc.

## Consolidated Statement of Operations

	Year Ended	
	December 31, 2011	December 31, 2010
<b>Unrestricted Revenue, Gains, and Other Support</b>		
Net patient service revenue	\$ 246,792,771	\$ 244,922,776
Investment income (Note 5)	(412,993)	9,637,565
Other revenue	3,322,763	3,248,761
Medicaid disproportionate share revenue	48,552,178	32,000,000
Net assets released from restrictions used for operations	396,631	86,007
Total unrestricted revenue, gains, and other support	298,651,350	289,895,109
<b>Operating Expenses</b>		
Salaries and wages	106,996,138	107,500,017
Employee benefits and payroll taxes	26,761,229	23,362,225
Supplies	47,766,832	47,011,395
Outside services	44,420,464	42,122,095
Professional and other liability costs	2,185,528	2,424,601
Utilities	6,557,103	6,546,658
Repairs and maintenance	7,399,828	6,678,524
Depreciation and amortization	17,891,380	18,703,323
Provision for bad debts	10,872,378	6,810,700
Interest expense	5,938,159	6,478,999
Other	7,701,603	7,192,263
Total operating expenses (Note 16)	284,490,642	274,830,800
<b>Operating Income</b>	14,160,708	15,064,309
<b>Nonoperating Income</b> - Electronic health records incentive payments	5,094,998	-
<b>Excess of Revenue Over Expenses</b>	19,255,706	15,064,309
<b>Pension-related Changes Other than Net Periodic Cost</b>	(15,570,432)	(1,612,908)
<b>Increase in Unrestricted Net Assets</b>	<u>\$ 3,685,274</u>	<u>\$ 13,451,401</u>

# The Methodist Hospitals, Inc.

## Consolidated Statement of Changes in Net Assets

	Year Ended	
	December 31, 2011	December 31, 2010
<b>Unrestricted Net Assets</b>		
Excess of revenue over expenses	\$ 19,255,706	\$ 15,064,309
Pension-related changes other than net periodic cost	(15,570,432)	(1,612,908)
<b>Increase in Unrestricted Net Assets</b>	3,685,274	13,451,401
<b>Temporarily Restricted Net Assets</b>		
Restricted contributions	113,834	97,895
Net assets released from restriction	(396,631)	(86,007)
<b>(Decrease) Increase in Temporarily Restricted Net Assets</b>	(282,797)	11,888
<b>Increase in Net Assets</b>	3,402,477	13,463,289
<b>Net Assets - Beginning of year</b>	179,837,834	166,374,545
<b>Net Assets - End of year</b>	<b>\$ 183,240,311</b>	<b>\$ 179,837,834</b>

# The Methodist Hospitals, Inc.

## Consolidated Statement of Cash Flows

	Year Ended	
	December 31, 2011	December 31, 2010
<b>Cash Flows from Operating Activities</b>		
Increase in net assets	\$ 3,402,477	\$ 13,463,289
Adjustments to reconcile increase in net assets to net cash from operating activities:		
Depreciation and amortization	17,891,380	18,703,323
Net change in unrealized net losses (gains) on investments	3,756,254	(5,235,605)
Realized gains on investments	(182,054)	(300,097)
Pension-related changes other than net periodic costs	15,570,432	1,612,908
Loss on disposal of property and equipment	31,646	219,892
Temporarily restricted contributions	(113,834)	(97,895)
Provision for bad debts	10,872,378	6,810,700
Changes in assets and liabilities that (used) provided cash:		
Accounts receivable	(23,362,967)	(5,482,991)
Other current assets	298,487	(310,970)
Cost report settlements receivable	(26,153,626)	21,153,622
Other assets	312,957	784,075
Accounts payable	1,596,597	(2,235,080)
Accrued liabilities	(68,007)	1,698,417
Cost report settlements payable	(386,603)	1,785,462
Other liabilities	(5,237,234)	(6,821,189)
Net cash (used in) provided by operating activities	(1,771,717)	45,747,861
<b>Cash Flows from Investing Activities</b>		
Purchase of property and equipment	(14,652,065)	(18,473,805)
Net change in assets limited as to use and investments	7,224,163	(2,572,293)
Net cash used in investing activities	(7,427,902)	(21,046,098)
<b>Cash Flows from Financing Activities</b>		
Principal payment on long-term debt	(3,330,000)	(3,145,000)
Payments on capital lease obligations	(2,395,503)	(177,609)
Temporarily restricted contributions	113,834	97,895
Net cash used in financing activities	(5,611,669)	(3,224,714)
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	(14,811,288)	21,477,049
<b>Cash and Cash Equivalents - Beginning of year</b>	34,156,290	12,679,241
<b>Cash and Cash Equivalents - End of year</b>	<b>\$ 19,345,002</b>	<b>\$ 34,156,290</b>
<b>Supplemental Cash Flow Information - Cash paid for interest</b>	<b>\$ 5,993,098</b>	<b>\$ 6,427,122</b>

# **The Methodist Hospitals, Inc.**

## **Notes to Consolidated Financial Statements December 31, 2011 and 2010**

### **Note 1 - Nature of Business and Significant Accounting Policies**

**Organization** - The Methodist Hospitals, Inc. (the "Hospital") is an Indiana nonprofit corporation operating a 302-bed general acute-care facility in Gary, Indiana (Northlake Campus), and a 313-bed general acute-care facility in Merrillville, Indiana (Southlake Campus). The Hospital also provides physician services to patients through the following wholly owned limited liability companies: Methodist Cardiographics, LLC, Methodist Anesthesia, LLC, and Methodist Pathology, LLC.

During 2009, the Hospital established The Methodist Hospitals Foundation, Inc. (the "Foundation") to support and benefit the Hospital. The Foundation has been accounted for within the Hospital's financial statements. Intercompany accounts have been eliminated in consolidation.

**Cash and Cash Equivalents** - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use. The Hospital's cash balances are only insured up to the FDIC limit. As of December 31, 2011, there was approximately \$17.9 million of uninsured cash.

**Accounts Receivable** - Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Hospital's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

**Investments** - Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheet. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law.

**Inventories** - Inventories, which consist of medical and office supplies and pharmaceutical products, are stated at cost, determined on a first-in, first-out basis or market.



# **The Methodist Hospitals, Inc.**

## **Notes to Consolidated Financial Statements December 31, 2011 and 2010**

### **Note I - Nature of Business and Significant Accounting Policies (Continued)**

**Assets Limited as to Use** - Assets limited as to use include assets set aside by the governing board for future capital improvement, over which the board retains control, and may, at its discretion, subsequently use for other purposes, assets held by trustees under bond indenture agreements, and assets held in self-insurance trust arrangements. Restricted foundation investments consist of assets whose use by the Hospital has been restricted by the donor.

**Property and Equipment** - Property and equipment amounts are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements.

**Classification of Net Assets** - Net assets of the Hospital are classified as permanently restricted, temporarily restricted, or unrestricted depending on the presence and characteristics of donor-imposed restrictions limiting the Hospital's ability to use or dispose of contributed assets or the economic benefits embodied in those assets. Donor-imposed restrictions that expire with the passage of time or that can be removed by meeting certain requirements result in temporarily restricted net assets. Permanently restricted net assets result from donor-imposed restrictions that limit the use of net assets in perpetuity. Earnings, gains, and losses on restricted net assets are classified as unrestricted unless specifically restricted by the donor or by applicable state law.

**Excess of Revenue Over Expenses** - The consolidated statement of operations includes excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from excess of revenue over expenses consistent with industry practice, include net assets released from restrictions for the acquisition of long-lived assets and pension-related changes other than periodic benefit costs.

**Net Patient Service Revenue** - The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

# **The Methodist Hospitals, Inc.**

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## **Notes to Consolidated Financial Statements December 31, 2011 and 2010**

### **Note 1 - Nature of Business and Significant Accounting Policies (Continued)**

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

**Contributions** - The Hospital reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of changes in net assets as net assets released from restrictions.

The Hospital reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Hospital reports the expiration of donor restrictions when the assets are placed in service.

**Professional and Other Liability Insurance** - The Hospital accrues an estimate of the ultimate expense, including litigation and settlement expense, net of applicable reinsurance coverage, for incidents of potential improper professional service and other liability claims occurring during the year as well as for those claims that have not been reported at year end.

**Charity Care** - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The amount reflects the cost of free or discounted health services, net of contributions, and other revenue received, as direct assistance for the provision of charity care. The estimated cost of providing charity services is based on a calculation which applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients.

# **The Methodist Hospitals, Inc.**

## **Notes to Consolidated Financial Statements December 31, 2011 and 2010**

### **Note 1 - Nature of Business and Significant Accounting Policies (Continued)**

**Accounting for Conditional Asset Retirement Obligation** - Management has considered its legal obligation to report asset retirement activities, such as asbestos removal, on its existing properties. Over the past 20 years, management has systematically renovated, replaced, or constructed the majority of the physical plant facilities, resulting in a relatively small portion of the facility with any remaining hazardous material. Management has calculated the present value of the retirement obligation and the amount has been recognized as a liability on the consolidated balance sheet within other liabilities.

**Electronic Health Records Incentive Payments** - The American Recovery and Reinvestment Act of 2009 (ARRA) established funding in order to provide incentive payments to hospitals and physicians that implement the use of electronic health record (EHR) technology by 2014. The Hospital may receive an incentive payment for up to four years, provided the Hospital demonstrates meaningful use of certified EHR technology for the EHR reporting period. The revenue from the incentive payments is recognized ratably over the EHR reporting period when there is reasonable assurance that the Hospital will comply with eligibility requirements during the EHR reporting period and an incentive payment will be received. The Hospital has recognized the incentive payments received in nonoperating revenue.

**Tax Status** - The Hospital is a nonprofit, tax-exempt organization, and is exempt from federal income taxes on related income pursuant to Section 501(c)(3) of the Internal Revenue Code and, accordingly, no tax provision is reflected in the consolidated financial statements. The Hospital's tax returns are not subject to examination by taxing authorities for years beginning prior to December 31, 2008.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 1 - Nature of Business and Significant Accounting Policies (Continued)

**New Accounting Pronouncement** - During 2011, the Financial Accounting Standards Board (FASB) adopted Accounting Standards Update (ASU) 2011-07, *Health Care Entities (Topic 954) Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, establishing accounting and disclosures for healthcare entities that recognize significant amounts of patient service revenue at the time services are rendered even though the entities do not assess a patient's ability to pay. The amendments in the ASU change the presentation of the statement of operations and add new disclosures that are not required under current GAAP for entities within the scope of this update. The provision for bad debts associated with patient service revenue for certain entities is required to be presented on a separate line as a deduction from patient service revenue (net of contractual allowances and discounts) in the statement of operations. The ASU is effective for the Hospital for the year ending December 31, 2012.

**New Accounting Pronouncement** - The Hospital has adopted Accounting Standards Update (ASU) 2010-24, *Health Care Entities (Topic 954) Presentation of Insurance Claims and Related Insurance Recoveries*, for the year ended December 31, 2011. In accordance with the ASU, the accrued liability for malpractice claims and similar liabilities and the related insurance recovery receivable has been presented separately on the consolidated balance sheet on a gross basis for the year ended December 31, 2011. Prior guidance allowed the liability to be reported net of the estimated insurance recovery receivable. There was no impact on beginning net assets related to the implementation of this ASU. The amount of insurance recovery receivables included in other current assets totaled approximately \$230,000 at December 31, 2011.

**Subsequent Events** - The consolidated financial statements and related disclosures include evaluation of events up through and including April 20, 2012, which is the date the consolidated financial statements were available to be issued.

### Note 2 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2011	2010
Patient accounts receivable	\$ 104,744,638	\$ 92,140,380
Less allowance for uncollectible accounts	(18,008,370)	(19,430,369)
Less allowance for contractual adjustments	(55,922,855)	(54,387,187)
Net patient accounts receivable	<u>\$ 30,813,413</u>	<u>\$ 18,322,824</u>

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 2 - Patient Accounts Receivable (Continued)

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	Percentage	
	2011	2010
Medicare	34 %	29 %
Commercial and managed care	31	36
Medicaid	13	13
Self-pay	22	22
Total	100 %	100 %

### Note 3 - Cost Report Settlements

A significant portion of the Hospital's net patient service revenue is received from the Medicare and Medicaid programs. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - Inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.
- **Medicaid** - Inpatient and outpatient services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge or per procedure.
- **Other Third-party Payors** - The Hospital has also entered into agreements with certain commercial carriers, health maintenance organizations, and preferred provider organizations. The basis for reimbursement to the Hospital under these agreements is discounts from established charges, prospectively determined rates per discharge, and prospectively determined daily rates.

The Hospital qualifies as a Medicaid Disproportionate Share (DSH) provider under Indiana law and, as such, is eligible to receive DSH payments linked to the State of Indiana's fiscal year, which is June 30. The Hospital records DSH program revenue and receivables when the related amounts are determinable and when collectibility is reasonably assured.

# **The Methodist Hospitals, Inc.**

## **Notes to Consolidated Financial Statements December 31, 2011 and 2010**

### **Note 3 - Cost Report Settlements (Continued)**

At December 31, 2011 and 2010, the Hospital recorded approximately \$26.2 million and \$0, respectively, in amounts due from the State of Indiana under the DSH program. These amounts are included as part of third-party payor settlements. The amounts recorded represent estimated reimbursement due to the Hospital for services provided through the State fiscal year 2011. During the years ended December 31, 2011 and 2010, approximately \$22 million and \$55 million, respectively, was received in cash related to the DSH program.

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare and Medicaid programs that are subject to audit by fiscal intermediaries. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The Medicare program has initiated a recovery audit contractor (RAC) initiative, whereby claims subsequent to October 1, 2007 will be reviewed by contractors for validity, accuracy, and proper documentation. The Hospital is unable to determine the extent of liability for overpayments, if any.

### **Note 4 - Charity Care**

In support of its mission, the Hospital's policy is to treat patients in need of medical services without regard to their ability to pay for such services. Charity care covers services provided to persons who cannot afford to pay. Charity care is determined based on established policies, using patient income and assets to determine payment ability. The amount reflects the cost of free or discounted health services, net of contributions and other revenue received, as direct assistance for the provision of charity care. The estimated cost of providing charity services is based on a calculation which applies a ratio of cost to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total expenses less bad debt expense divided by gross patient service revenue. The Hospital estimates that it provided approximately \$13.8 million and \$15.6 million of services to indigent patients during 2011 and 2010, respectively.

In addition, the Hospital performs many activities of community benefit, including programs provided to persons with inadequate healthcare resources or for other groups within the community that need special services and support. Examples include programs related to the poor, elderly, substance abuse, child abuse, and others with specific particular healthcare needs. They also include broader populations who benefit from health community initiatives such as health promotion, education, and health screening.

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 4 - Charity Care (Continued)

The Hospital also participates in the Medicare and Medicaid programs. At present, the reimbursement rates for both programs do not fully cover the cost of providing care to these patients. This represents the estimated "shortfall" created when a facility receives payments below the costs of treating Medicare and Medicaid beneficiaries. These uncompensated costs are not included above.

### Note 5 - Assets Limited as to Use

The details of assets limited as to use are summarized in the following schedule:

	2011	2010
Funds held by trustees under bond indenture	\$ 8,523,776	\$ 8,475,812
Funds held in trust for payment of professional and other liability claims	7,579,594	7,741,532
Funds held by board for future capital improvements	113,649,238	125,855,916
Funds held by donors for specific purposes	25,000	25,000
Subtotal	129,777,608	142,098,260
Less amount for payment of current liabilities	(2,489,027)	(640,061)
Total assets limited as to use and permanently or temporarily restricted	<u>\$ 127,288,581</u>	<u>\$ 141,458,199</u>

Investments, including short-term investments, consist of the following:

	2011	2010
Money market investments	\$ 14,326,278	\$ 16,591,962
Government securities	4,793,829	28,616,522
Mutual funds	48,806,643	44,245,740
Corporate bonds	61,811,678	51,261,914
Pooled funds	4,746,581	4,567,234
Total	<u>\$ 134,485,009</u>	<u>\$ 145,283,372</u>
Classified as:		
Short-term investments	\$ 4,707,401	\$ 3,185,112
Current portion of assets limited as to use	2,489,027	640,061
Noncurrent portion of assets limited as to use	<u>127,288,581</u>	<u>141,458,199</u>
Total	<u>\$ 134,485,009</u>	<u>\$ 145,283,372</u>

Funds held by the trustee under bond indenture are held for the purpose of making future bond principal and interest payments. Investment income accrues to the funds as earned.

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 5 - Assets Limited as to Use (Continued)

Investment income and gains and losses are comprised of the following for the years ended December 31, 2011 and 2010:

	2011	2010
Interest and dividends	\$ 3,161,207	\$ 4,101,863
Change in net unrealized gains and losses on investments	(3,756,254)	5,235,605
Realized gains and losses - Net	182,054	300,097
Total	<u>\$ (412,993)</u>	<u>\$ 9,637,565</u>

### Note 6 - Fair Value Measurements

Accounting standards require certain assets and liabilities be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value.

The following tables present information about the Hospital's assets measured at fair value on a recurring basis at December 31, 2011 and 2010 and the valuation techniques used by the Hospital to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the Hospital has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Hospital's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.



# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 6 - Fair Value Measurements (Continued)

#### Assets Measured at Fair Value on a Recurring Basis at December 31, 2011

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2011
<b>Short-term Investments -</b>				
Money market investments	\$ 4,707,401	\$ -	\$ -	\$ 4,707,401
<b>Assets Limited as to Use</b>				
Money market investments	11,046,095	-	-	11,046,095
Mutual funds:				
U.S. companies	24,532,705	-	-	24,532,705
International companies	16,694,442	-	-	16,694,442
Fixed income	5,057,177	-	-	5,057,177
Fixed income:				
U.S. Treasuries	-	4,278,045	-	4,278,045
Governmental agency bonds	-	3,296,902	-	3,296,902
Pooled funds	-	4,746,581	-	4,746,581
Asset-backed securities	-	17,725,028	-	17,725,028
Mortgage-backed securities	-	16,381,235	-	16,381,235
Corporate - Domestic	-	19,416,698	-	19,416,698
Corporate - International	-	5,891,466	-	5,891,466
Total assets limited as to use	57,330,419	71,735,955	-	129,066,374
<b>Total</b>	<b>\$ 62,037,820</b>	<b>\$ 71,735,955</b>	<b>\$ -</b>	<b>\$ 133,773,775</b>

The assets limited as to use and short-term investments included in the consolidated balance sheet at December 31, 2011 included cash and cash equivalents of \$711,234, which are not measured at fair value on a recurring basis and therefore are not in the table above.

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 6 - Fair Value Measurements (Continued)

#### Assets Measured at Fair Value on a Recurring Basis at December 31, 2010

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2010
<b>Short-term Investments -</b>				
Money market investments	\$ 3,185,112	\$ -	\$ -	\$ 3,185,112
<b>Assets Limited as to Use</b>				
Money market investments	12,649,649	-	-	12,649,649
Mutual funds:				
U.S. companies	23,122,603	-	-	23,122,603
International companies	17,485,079	-	-	17,485,079
Fixed income	3,638,057	-	-	3,638,057
Fixed income:				
U.S. Treasuries	-	26,660,459	-	26,660,459
Governmental agency bonds	-	1,956,063	-	1,956,063
Pooled funds	-	4,567,234	-	4,567,234
Asset-backed securities	-	18,517,076	-	18,517,076
Mortgage-backed securities	-	13,876,756	-	13,876,756
Corporate - Domestic	-	15,001,580	-	15,001,580
Corporate - International	-	3,866,502	-	3,866,502
Total assets limited as to use	56,895,388	84,445,670	-	141,341,058
Total	\$ 60,080,500	\$ 84,445,670	\$ -	\$ 144,526,170

The assets limited as to use and short-term investments included in the consolidated balance sheet at December 31, 2010 included cash and cash equivalents of \$757,202, which are not measured at fair value on a recurring basis and therefore are not in the table above.

### Note 7 - Other Current Assets

The details of other assets at December 31, 2011 and 2010 are as follows:

	2011	2010
Prepaid expenses	\$ 2,787,137	\$ 2,907,315
Inventory	6,990,069	7,544,392
Other	1,245,865	869,851
Total	\$ 11,023,071	\$ 11,321,558

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 8 - Property and Equipment

The cost of property, plant, and equipment and depreciable lives are summarized as follows:

	2011	2010	Depreciable Life - Years
Land	\$ 3,745,499	\$ 3,745,499	-
Buildings	236,672,426	237,442,311	2-40
Equipment	204,196,651	195,403,510	3-5
Construction in progress	2,595,927	3,582,359	-
Total cost	447,210,503	440,173,679	
Accumulated depreciation	(324,379,649)	(314,071,864)	
Net property and equipment	<u>\$ 122,830,854</u>	<u>\$ 126,101,815</u>	

Depreciation and amortization expense on property and equipment totaled approximately \$17,891,000 and \$18,659,000 in 2011 and 2010, respectively. The Hospital holds buildings and equipment under capital leases with an original cost of approximately \$22,100,000 and \$24,400,000 at December 31, 2011 and 2010, respectively. Accumulated amortization for buildings and equipment under capital lease obligations was approximately \$8,988,000 and \$9,587,000 at December 31, 2011 and 2010, respectively.

Construction in progress consists primarily of costs incurred for the installation and implementation of software systems and installation of various clinical equipment. Remaining costs to complete the project are approximately \$12,220,000 as of December 31, 2011.

### Note 9 - Accrued Liabilities and Other

The details of accrued liabilities at December 31, 2011 and 2010 are as follows:

	2011	2010
Payroll and related items	\$ 7,612,306	\$ 7,143,529
Compensated absences	6,385,385	6,814,896
Interest	1,063,947	1,118,886
Other	-	52,334
Total accrued liabilities	<u>\$ 15,061,638</u>	<u>\$ 15,129,645</u>

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 10 - Long-term Debt

A summary of long-term debt and capital lease obligations at December 31, 2011 and 2010 follows:

	2011	2010
Indiana Health Facility Financing Authority Revenue Bonds, Series 1996, interest at 6.00 percent, due in installments through 2016	\$ 10,780,000	\$ 12,585,000
Indiana Health Facility Financing Authority Revenue Bonds, Series 2001, interest ranging from 4.30 percent to 5.50 percent, due in installments through 2031	55,165,000	56,690,000
Urgent care and ambulatory surgery center capital lease obligation, expires June 30, 2030, collateralized by the leased buildings	-	2,219,737
Urgent care building capital lease obligation, expires October 31, 2020, collateralized by the leased building	1,334,320	1,402,483
Medical office building capital lease obligations, expires December 31, 2045, collateralized by leased medical office buildings	19,976,325	20,082,166
Total - Before unamortized discount	87,255,645	92,979,386
Less original issue discount	(196,157)	(197,919)
Less current portion	3,703,792	3,518,507
Long-term portion	<u>\$ 83,748,010</u>	<u>\$ 89,658,798</u>

The Indiana Health Facility Financing Authority (the "IHFFA") has issued bonds on behalf of The Methodist Hospitals, Inc. Obligated Group (the "Obligated Group") and has loaned the proceeds to the Obligated Group under the terms of the master indenture.

Hospital Obligated Group Bonds Payable, Series 1996 consist of hospital revenue bonds issued by the IHFFA. The bonds consist of term bonds payable in annual installments beginning in 2012 through 2016, ranging from \$1,910,000 to \$2,415,000 at an interest rate of 6 percent.

Hospital Obligated Group Bonds Payable, Series 2001 consist of hospital revenue bonds issued by the IHFFA. The bonds consist of serial bonds payable in annual installments ranging from \$1,600,000 in 2012 to \$1,685,000 in 2013, at interest rates ranging from 4.30 percent to 4.98 percent, and term bonds payable in annual installments beginning in 2014 through 2031, ranging from \$1,775,000 to \$4,365,000 at interest rates ranging from 5.375 percent to 5.50 percent.

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 10 - Long-term Debt (Continued)

The Series 1996 and 2001 Bonds have been issued under a master trust indenture and are secured by the gross revenue of the Hospital. In connection with the bond indenture and loan agreements, the Obligated Group is subject to certain financial covenants related to, among others, transfer of assets, restrictions on additional indebtedness, and maintenance of certain financial covenants, including a minimum debt service coverage ratio and minimum debt service reserve funds.

The Hospital has entered into a series of capital lease arrangements for a medical office building on the Merrillville hospital campus. The Hospital is leasing the underlying land to the developer under terms of a ground lease. The medical office building houses physician offices, laboratory and diagnostic facilities, and an ambulatory surgery center. The lease agreements have terms from 25 to 40 years.

During 2011, one of the capital leases was terminated. As of April 1, 2011, the Hospital was released from further obligations related to the capital lease. Approximately \$400,000 was transferred upon termination in relation to accrued taxes. Additional depreciation for 2010 was approximately \$1,525,000 based on the change in estimate of the asset's useful life.

Scheduled principal repayments on long-term debt and payments on capital lease obligations are as follows as of December 31, 2011:

<u>Years Ending December 31</u>	<u>Long-term Debt</u>	<u>Capital Lease Obligations</u>
2012	\$ 3,510,000	\$ 2,005,224
2013	3,710,000	2,005,224
2014	3,925,000	2,005,224
2015	4,150,000	2,005,224
2016	4,385,000	2,005,224
Thereafter	46,265,000	32,237,079
Total	65,945,000	42,263,199
Less amount representing interest under capital lease obligations	-	(20,952,554)
Total debt and present value of minimum lease payments	<u>\$ 65,945,000</u>	<u>\$ 21,310,645</u>

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 11 - Other Liabilities

The detail of other liabilities is shown below:

	2011	2010
Accrued pension cost (Note 14)	\$ 35,342,417	\$ 25,304,918
Accrued professional and other liability claims (Note 15)	7,106,418	6,867,887
Other	1,267,831	1,210,663
Total other liabilities	<u>\$ 43,716,666</u>	<u>\$ 33,383,468</u>

### Note 12 - Operating Leases

The Hospital is obligated under certain operating leases, primarily for facilities and equipment. Total rent expense under these leases was approximately \$1,451,000 and \$1,459,000 for the years ended December 31, 2011 and 2010, respectively.

The following is a schedule of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year:

Years Ending December 31	Amount
2012	\$ 1,208,640
2013	657,413
2014	221,244
2015	31,754
Total	<u>\$ 2,119,051</u>

### Note 13 - Defined Contribution Plan

The Hospital established a defined contribution pension plan effective January 1, 2006, which allows for employee contributions and requires a matching employer contribution of 50 percent of the first 6 percent of employees' earnings. Expense for the years ended December 31, 2011 and 2010 was approximately \$1,520,000 and \$1,150,000, respectively.

### Note 14 - Pension and Other Postretirement Benefit Plans

The Methodist Hospitals, Inc. participates in a defined benefit pension plan covering certain employees.

The board of trustees of the Hospital elected to freeze the employees' participation in the future accrual of benefits under the existing defined benefit plan effective December 31, 2005.

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 14 - Pension and Other Postretirement Benefit Plans (Continued)

Effective June 1, 2007, the plan was amended to provide early retirement window benefits to participants who had attained age 50 and completed 10 or more years of service on or before June 30, 2007. Under the terms of the amendment, eligible participants who elected to participate received three years of additional benefits accrual based on 2006 compensation, and the early retirement reduction was calculated assuming a participant was 50 years or older. Participants were allowed to take their full benefit as a lump sum. A significant portion of participants eligible for the early retirement program elected to participate in the program.

#### Obligations and Funded Status

	Pension Benefits	
	2011	2010
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 89,723,836	\$ 82,590,217
Service cost	33,000	100,000
Interest cost	4,927,379	4,874,102
Actuarial loss	9,826,667	5,261,853
Benefits paid	(3,123,807)	(3,102,336)
Benefit obligation at end of year	101,387,075	89,723,836
Change in plan assets:		
Fair value of plan assets at beginning of year	64,418,918	54,043,986
Actual return on plan assets	(850,453)	7,777,268
Employer contributions	5,600,000	5,700,000
Benefits paid	(3,123,807)	(3,102,336)
Fair value of plan assets at end of year	66,044,658	64,418,918
Funded status at end of year	\$ (35,342,417)	\$ (25,304,918)

Components of net periodic benefit cost and other amounts recognized are as follows:

	Pension Benefits	
	2011	2010
<b>Net Periodic Benefit Cost</b>		
Service cost	\$ 33,000	\$ 100,000
Interest cost	4,927,379	4,874,102
Expected return on plan assets	(4,893,312)	(4,128,323)
Amortization of net loss	342,485	310,547
Total	\$ 409,552	\$ 1,156,326

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 14 - Pension and Other Postretirement Benefit Plans (Continued)

Included in unrestricted net assets are the following amounts that have not yet been recognized in net periodic pension cost:

	Pension Benefits	
	2011	2010
Net gain	\$ 15,570,432	\$ 1,612,908

#### Assumptions

Weighted average assumptions used to determine benefit obligations at December 31 are as follows:

	Pension Benefits	
	2011	2010
Discount rate	4.90 %	5.60 %

Weighted average assumptions used to determine net periodic benefit cost for years ended December 31 are as follows:

	Pension Benefits	
	2011	2010
Discount rate	5.60 %	6.00 %
Expected long-term return on plan assets	7.40	7.40

In selecting the expected long-term rate of return on assets, the Hospital considered the average rate of earnings expected on the funds invested or to be invested to provide for the benefits of this plan. This included considering the allocation of trust assets and the expected returns likely to be earned over the life of the plan.

#### Pension Plan Assets

The goals of the pension plan investment program are to fully fund the obligation to pay retirement benefits in accordance with the plan documents and to provide returns that, along with appropriate funding from the Hospital, maintain an asset/liability ratio that is in compliance with all applicable laws and regulations and assures timely payment of retirement benefits. Pension funds are invested in growth-oriented securities up to 65 percent in equities, including international equities.

The target allocation range of percentages for plan assets is 65 percent equity securities and 35 percent debt securities as of December 31, 2011 and 2010.



# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 14 - Pension and Other Postretirement Benefit Plans (Continued)

The fair values of the Hospital's pension plan assets at December 31, 2011 by major asset categories are as follows:

#### Fair Value Measurements at December 31, 2011

Asset Category	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities:				
U.S. companies	\$ 26,227,015	\$ 26,227,015	\$ -	\$ -
International companies	16,552,924	16,552,924	-	-
Debt securities	20,279,082	-	20,279,082	-
Fixed income - Pooled funds	2,891,827	-	2,891,827	-
Total	<u>\$ 65,950,848</u>	<u>\$ 42,779,939</u>	<u>\$ 23,170,909</u>	<u>\$ -</u>

#### Fair Value Measurements at December 31, 2010

Asset Category	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities:				
U.S. companies	\$ 24,628,725	\$ 24,628,725	\$ -	\$ -
International companies	17,060,615	17,060,615	-	-
Debt securities	19,932,481	-	19,932,481	-
Fixed income - Pooled funds	2,782,561	-	2,782,561	-
Total	<u>\$ 64,404,382</u>	<u>\$ 41,689,340</u>	<u>\$ 22,715,042</u>	<u>\$ -</u>

The pension plan assets shown above included cash and cash equivalents of \$93,810 and \$14,536 at December 31, 2011 and 2010, respectively. Cash and cash equivalents are not measured at fair value on a recurring basis and therefore are not included in the table above.

The above tables present information about the pension and postretirement benefit plan assets measured at fair value at December 31, 2011 and 2010 and the valuation techniques used by the Hospital to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Hospital has the ability to access.

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 14 - Pension and Other Postretirement Benefit Plans (Continued)

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Hospital's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each plan asset.

#### Cash Flow

##### **Contributions**

The Hospital expects to contribute \$5.6 million to the pension plan in 2011.

##### **Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

<u>Years Ending December 31</u>	<u>Pension Benefits</u>
2012	\$ 3,293,518
2013	3,487,182
2014	3,666,593
2015	3,842,811
2016	4,065,937
2017-2021	24,891,137

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 15 - Professional Liability Self-insurance

On April 2, 1983, the Hospital became qualified under the Indiana Medical Malpractice Act (the "Act") to adopt the policy of self-insuring its professional liability risks for individual losses up to \$250,000 per claim and \$7,500,000 annually. In addition, the self-insurance plan has specified annual aggregate limits. The Hospital carries commercial insurance coverage for incidents that would exceed coverages specified by the self-insurance program. Prior to April 2, 1983, the Hospital carried commercial insurance for professional liability risks on an occurrence basis. The Hospital's liability for medical malpractice self-insurance is actuarially determined based upon the Hospital's estimated claims reserves and various assumptions, and includes an estimate for claims incurred but not yet reported.

In connection with the self-insurance program, the Hospital established a trust. Under the trust agreement, the trust assets can only be used for payment of professional liability losses, related expenses, and the costs of administering the trust. The assets of the trust are included in unrestricted funds and income from the trust assets and administrative costs are included in the statement of operations.

### Note 16 - Functional Expenses

The Hospital provides general healthcare services to residents within its geographical location.

Expenses related to providing these services are as follows:

	2011	2010
Healthcare services	\$ 253,896,858	\$ 244,604,094
General and administrative	30,593,784	30,226,706
Total	<u>\$ 284,490,642</u>	<u>\$ 274,830,800</u>

### Note 17 - Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

**Cash and Cash Equivalents** - The carrying amount approximates fair value because of the short maturity of those instruments.

**Investments** - Fair values, which are the amounts reported in the balance sheet, are based on quoted market prices.

**Accounts Receivable, Accounts Payable, and Accrued Liabilities** - The carrying amount reported in the balance sheet for accounts receivable, accounts payable, and accrued liabilities approximates its fair value.

# The Methodist Hospitals, Inc.

## Notes to Consolidated Financial Statements December 31, 2011 and 2010

### Note 17 - Fair Value of Financial Instruments (Continued)

**Estimated Third-party Payor Settlements - Net** - The carrying amount reported in the balance sheet for estimated third-party payor settlements - net approximates its fair value.

**Long-term Debt** - The fair value of the Hospital's bonds is estimated based on current traded value. The fair value of the Hospital's remaining debt is estimated using discounted cash flow analysis, based on current investment borrowing rates for similar types of borrowing arrangements.

The estimated fair value of the Hospital's long-term debt is as follows:

	Carrying Amount	Fair Value
2011 - Long-term debt	\$ 87,452,000	\$ 83,970,000
2010 - Long-term debt	93,177,000	86,105,000